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Latin America and the World Recession

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4 Latin American and East Asian NICs: Development Strategies Compared

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The newly industrializing countries (NICs) of Latin America have, until recently, achieved surprisingly high rates of economic growth. Even after the first oil shock in 1973, the Latin American NICs were able to maintain respectable growth rates by increasing their foreign borrowing, and their active demand for Western goods helped to soften the impact of world recession. They were less successful after 1979, however, in adjusting to the second round of inflation, which was accompanied by high real interest rates and increasing protectionism. The problems of the Latin American countries have become more acute in the past two to three years; because OPEC surpluses have virtually disappeared, while at the same time debtor countries have found it increasingly difficult to repay even the interest on previous debt, commercial banks are now both less able and less willing to make fresh loans available. Growth among the Latin American countries has ground to a halt, and their massive external debts appear to threaten the stability of the international financial system.

Yet it would be wrong to attribute these difficulties entirely to the state of the world economy or to seek their solution by calling either for tougher IMF stabilization programmes or for increased international liquidity. The unfavourable world economic environment has merely highlighted problems inherent in the basic economic development path of these countries but previously masked by the extraordinary global prosperity of the early post-war era.

It is worth distinguishing between the Latin American and East Asian NICs. Although growth rates were similar in both groups until recently, substantial differences are now emerging which had previously been masked by rising world growth rates and, after 1973, by the ability of the Latin American countries to attract large foreign loans. The East Asian NICs have faced the same problems in the world economy but have coped reasonably well since 1979, with only slightly reduced growth rates and

without serious debt problems. Moreover, throughout the entire post-war period, the East Asian NICs have been far more successful in reducing poverty and unemployment.

This chapter will examine the East Asian development pattern in an attempt to discover why these countries have apparently been able to achieve growth with equity as well as, more recently, adapting to continued global recession, protectionism and high interest rates. It will then review the typical development pattern of the Latin American NICs and present reasons for their generally relatively poorer performance. Finally, it will suggest some possible policy considerations.

II

Any attempt to compare groups of countries risks concealing as much as it reveals: important and instructive differences occur within any group, including the East Asian NICs. Nevertheless, a study of the past thirty years of development in the four East Asian countries, Hong Kong, Singapore, South Korea and Taiwan, does reveal strong underlying similarities, both in their original condition and in their subsequent mode of generating economic growth, all of which suggests that it is valid to generalize about the East Asian experience and to compare it with that of other developing countries.[1] This section will focus mainly on Taiwan and South Korea, because Hong Kong and Singapore, while members of the same group in most respects, are really city states whose size and relative absence of any agricultural sector make them extremely special, and their development pattern therefore less relevant to other developing countries.

All four countries are densely populated and poor in natural resources. They also share a cultural tradition which by the early 1950s had resulted in a high level of literacy and basic education among the large surplus labour force. Moreover, all four are relatively small, so that, given an abundance of high-quality labour and scarce natural resources, the international aspects of development – especially trade and capital flows – were likely to feature prominently.

By the early 1950s, both South Korea and Taiwan had a reasonably well-developed agricultural sector. While Taiwan possessed a rather more favourable climate, soil and potential for multiple cropping and technological innovation, both countries had benefited from the Japanese colonial investments in the rural sector, including the improvement of irrigation and the creation of farmers' organizations, in order to increase the production of food crops required by the mother country. There was also a fairly equal distribution of assets, especially land, in both countries – thanks to earlier Japanese reforms and subsequent, post-war, legislation. The distribution of land in Taiwan, for example, was roughly twice as equitable as in the rest of the developing world, including Latin America.

In Taiwan, during the colonial period, the agricultural sector produced the domestic food supply as well as traditional land-based exports (mainly rice and sugar) which helped to finance the import of manufactured non-durables, such as textiles. Korea differed slightly, in that it relied to a greater extent on mineral exports.

In the early 1950s, the East Asian NICs entered the customary first stage of post-colonial economic development by adopting a strategy of import-substituting industrialization. This began in Taiwan in about 1951 and South Korea in about 1952. Both countries continued to export traditional products (mainly cash crops in the case of Taiwan, while in South Korea, too, agricultural exports became increasingly important relative to mineral exports). But a part of the revenue from these exports was diverted from the purchase of non-durable manufactured imports to the purchase of producer goods (capital goods and processed raw materials) destined for emerging domestic industries whose production of non-durable consumer goods for the home market gradually replaced previous imports.

During this import-substitution phase, foreign trade declined as a proportion of national income because the policies associated with import-substitution favoured the domestic market and the protection of these new industries. Because of their long-run scarcity of natural resources, large surpluses of unskilled labour and good levels of education, the mobilization of human resources in the industrial process became increasingly important in the East Asian countries. Traditional populations were converted into modern factory workers; agricultural and commercial entrepreneurs were gradually turned into industrial entrepreneurs and managers, capable of applying modern science and technology; and civil servants, previously occupied in maintaining law and order, focused their attention on the promotion of economic development. Once the necessary skills had been acquired, East Asian industries would be able to compete successfully in international markets. In the mean time, however, policies were directed towards supporting industrial production for the domestic market, often with the help of foreign capital.

During the import-substitution phase, government policy is usually strongly protectionist. Because domestic industry is guaranteed profits even in the absence of productive efficiency, and because of distorted price signals, the industrial process, in terms of the choice of goods produced,

often remains inefficient – that is, prematurely skilled-labour-, capital- and technology-intensive. In addition, there tends to result a neglect of the rural sector, and, in particular, of food-producing agriculture. What is noteworthy in the case of the East Asian countries is that they adopted a relatively mild version of import-substitution. They paid more attention to the rural economy[2] and protected new industries less than was typical. Although the usual protectionist devices were adopted, including tariffs, import-licensing, overvalued exchange rates, and artificially low interest rates, their implementation in the East Asian countries was less severe, more flexible and more short-lived than in other developing countries.

Growth rates were high in South Korea and Taiwan during the first years of import-substitution but began to fall in both countries during the second half of the 1950s. The initial phase of import-substitution will eventually fail to sustain the same rate of economic growth; once the home market for non-durable goods is being supplied entirely by domestic industry, any further industrialization must slow to the pace of population and per-capita income change.

At this point, a choice has to be made between, on the one hand, maintaining import-substitution but shifting to the production of previously imported producer goods and durable consumer goods, or, on the other hand, commencing to export the same non-durable consumer goods previously supplied mainly to the home market. The East Asian countries, after a good deal of hesitation, chose the latter; the initial import-substitution phase came to an end in Taiwan about 1961 and in South Korea about 1964.

During this new 'export-substitution' phase, the basis of comparative advantage in trade moves from land to unskilled labour; exports of manufactured goods become increasingly important relative to agricultural and mineral exports. In both Taiwan and South Korea, industrial exports accounted for roughly 75 per cent of total exports by the end of the 1960s (Tables 4.1a, b, c). Moreover, the decline in trade as a proportion of national income was reversed – exports' share of GDP was soon substantially higher (Table 4.2). Export-substitution led to a greater integration of the East Asian economies into the world economy, in terms not only of the spectacular expansion of trade but also of increasing inflows of private capital, despite the considerable political and strategic uncertainties in the region.

The rate of labour reallocation from agriculture to industry also increased markedly in Taiwan and South Korea during this period because of the high rate of growth of labour-intensive industrial production now destined for

Table 4.1a *Agricultural exports' share in total exports, E_a/E (per cent)*

East Asian NICs	1950	1955	1960	1965	1970	1975	1977
Taiwan	87.9[a]	84.9	51.7	57.9	22.5	17.5	13.4
South Korea	23.1	34.7	51.4	25.3	16.7	15.1	9.7[b]
Hong Kong	30.4[c]	22.9	14.3	10.9	2.6	2.2	2.6[b]
Singapore	—	57.8[d]	61.6	44.5	44.7	22.0	21.9[b]
Latin American NICs	**1950**	**1955**	**1960**	**1965**	**1970**	**1975**	**1977**
Mexico	53.5	56.6	64.1	64.7	48.8	38.1	39.0
Colombia	83.1[a]	87.6	78.9	75.3	81.2	71.7	76.9
Chile	10.5	6.7	2.8	7.6[e]	7.5	17.3	22.0
Brazil	96.5[f]	95.4	88.9	80.8	75.2	57.9	50.0[b]

[a] Based on figures for 1951.
[b] Based on figures for 1979.
[c] Based on figures for 1952.
[d] Based on figures for 1956.
[e] Based on figures for 1966.
[f] Based on figures for 1953.
Source: UN, *Yearbook of International Trade Statistics.*

Table 4.1b *Mineral exports' share in total exports E_m/E (per cent)*

East Asian NICs	1950	1955	1960	1965	1970	1975	1977
Taiwan	3.8[a]	0.6	2.1	0.4	0.7	1.1	1.6
South Korea	70.9	49.7	8.3	22.7	8.3	7.9	8.1[b]
Hong Kong	2.8[c]	3.8	7.4	2.9	1.9	0.8	0.8[b]
Singapore	—	19.3[d]	12.7	17.4	25.6	36.3	27.4[b]
Latin American NICs	**1950**	**1955**	**1960**	**1965**	**1970**	**1975**	**1977**
Mexico	38.6	36.3	24.0	22.3	21.2	32.4	34.6
Colombia	16.3[a]	11.4	18.9	18.0	10.8	7.7	4.1
Chile	80.7	87.8	89.5	88.1[e]	88.3	77.1	67.9
Brazil	2.7[f]	2.9	8.1	11.7	14.3	16.7	16.5[b]

[a] Based on figures for 1951.
[b] Based on figures for 1979.
[c] Based on figures for 1952.
[d] Based on figures for 1956.
[e] Based on figures for 1966.
[f] Based on figures for 1953.
Source: UN, *Yearbook of International Trade Statistics.*

Table 4.1c *Manufactured exports' share in total exports, E_i/E (per cent)*

East Asian NICs	1950	1955	1960	1965	1970	1975	1978
Taiwan	8.3[a]	14.5	46.2	41.7	76.8	81.4	84.9
South Korea	6.4	16.0	40.3	52.0	74.9	76.8	81.9[b]
Hong Kong	66.8[c]	73.3	77.9	85.7	95.3	96.7	96.5[b]
Singapore	—	16.8[d]	19.7	28.9	26.7	39.9	43.7[b]
Latin American NICs	**1950**	**1955**	**1960**	**1965**	**1970**	**1975**	**1978**
Mexico	7.7	7.0	11.9	13.0	30.0	29.5	26.2
Colombia	0.5[a]	0.8	1.4	6.7	8.0	20.6	18.6[e]
Chile	1.1	0.1'	3.1	4.2[f]	4.0	5.3	9.7[e]
Brazil	0.7[g]	1.2	2.9	7.5	9.7	23.3	32.6[b]

[a] Based on figures for 1951.
[b] Based on figures for 1979.
[c] Based on figures for 1952.
[d] Based on figures for 1956.
[e] Based on figures for 1977.
[f] Based on figures for 1966.
[g] Based on figures for 1953.
Source: UN, *Yearbook of International Trade Statistics.*

Table 4.2 *Export orientation ratio (exports as percentage of GDP)*

East Asian NICs	1950	1955	1960	1965	1970	1975	1977
Taiwan	10.5	7.6	11.7	18.3	27.0[a]/29.6	41.2	53.8
South Korea	2.3	1.9	3.4	8.6	14.3	27.6	34.8
Hong Kong	—	—	84.0	76.9	99.7	94.3	95.1
Latin American NICs	**1950**	**1955**	**1960**	**1965**	**1970**	**1975**	**1977**
Mexico	18.7	16.7	10.3	9.3	8.2	7.7	10.5
Colombia	14.8[b]	13.6	15.6	11.4	14.2	15.1	17.4
Chile	10.2	9.3	13.8	14.0	16.0	19.8	17.3
Brazil	6.7	8.8	6.1	7.4	6.6	7.4	7.8

[a] Based on figures for 1969.
[b] Based on figures for 1953.
Source: UN, *Yearbook of International Trade Statistics*; UN, *Yearbook of National Accounts Statistics.*

relatively unlimited international markets. This reallocation led not only to a relative but also to an absolute decline in the agricultural labour force. Labour-intensive export industries made it possible for the first time for the large labour surpluses to be absorbed. In little more than a decade, this labour surplus had been exhausted in both countries, as shown by nearly constant unskilled wages giving way to rapidly rising ones.

This recorded shift to export-substitution required a change in government policies. To enable domestic industries to compete effectively in international markets, the degree of protection was reduced, exchange rates and interest rates were maintained at more realistic levels, and efforts were made to improve the usually depressed terms of domestic agriculture. In Taiwan and South Korea, this also involved direct government action, including the establishment of export-processing zones and the rebating of import duties on raw materials used by export industries, to help ease the transition. In addition, foreign aid was initially useful in ensuring the success of government reforms, although the rapid improvement in the economic climate, including a drastic reduction in the rate of inflation, encouraged increasing levels of domestic savings and foreign investment.

During the export-substitution phase growth rates were high in both South Korea and Taiwan. But the labour-intensive export phase also has its limits. Once the unskilled labour surplus has been exhausted, as it was in both countries by the early 1970s, with the advent of an actual labour shortage real wages begin to rise steadily. Industrial output and competitive exports tend therefore to become more skilled-labour-, technology- and capital-intensive. Thus, since the mid-1970s, Taiwan and South Korea have moved into the second phase of import- and export-substitution. They began producing previously imported capital goods, processed raw materials and durable consumer articles, at first for the domestic market, but very soon after for the international market since the new type of industrial production favoured greater economies of scale while the domestic market for these goods was still relatively small. As the economies of Taiwan and South Korea have become increasingly geared to industrial production, their agricultural sectors have shrunk, becoming mere appendages to the rest of the economy.

Growth rates in Taiwan and South Korea have continued to be very high during the past thirty years (Table 4.3). Yet equally impressive is the success of these countries in reducing unemployment and improving the distribution of income.

The improvement in income distribution – measured by the income share of the bottom 20 per cent of households (Table 4.4) – has been outstanding

Table 4.3 *Annual real per capita GNP growth rates (percentage per annum)*

	1950–1955	1955–1960	1960–1965	1965–1970	1970–1975	1975–1977
East Asian NICs	←PIS	→	←PES	→	←SIS	SES→
Taiwan	5.7[a]	2.8	5.1	6.2	5.7	8.3
South Korea	4.5[b]	1.5	3.2	7.5	7.1	9.5
Hong Kong	—	—	9.5[c]	5.8	3.8	12.0
Singapore	—	—	2.4	7.1	18.6	5.8
Latin American NICs	←PIS	→	←SIS→	←EP		→
Mexico	3.1	2.7	3.4	3.4	2.1	−1.0[d]
Colombia	3.0	1.7	1.4	3.0	3.3	—
Chile	3.3	1.6	2.5	2.0	−2.4	8.6
Brazil	2.8	6.2	1.6	4.5	7.4	3.8

[a] Based on figures for 1951–5.
[b] Based on figures for 1953–5.
[c] Based on figures for 1963–5.
[d] Based on figures for 1975–6.

PIS = Primary Import Substitution.
PES = Primary Export Substitution.
SIS = Secondary Import Substitution.
SES = Secondary Export Substitution.
EP = Export Promotion.

Source: Calculated from indices in UN, *Statistical Yearbook* (1978, United Nations Publication Sales No. E/F xvii.1, and other years); for Taiwan, calculated from IMF, *International Financial Statistics Yearbook* (Washington, D.C., 1979).

in comparison with other developing countries. In fact, it is not really surprising that income distribution improved after the mid-1970s. Once the labour surplus has been fully absorbed by labour-intensive industry during the export-substitution phase, it is usual for wages to rise and industrial output to become less unskilled-labour-intensive. This is supported both by the evidence of LDC development in general and by the rather crude analysis associated with Simon Kuznets' inverse U-shaped hypothesis.[3] What is more surprising is that, in both South Korea and Taiwan, the distribution of income seems actually to have improved during the period of most rapid early growth, contrary to the experience of other developing countries as well as to the Kuznets hypothesis.

It is possible to establish a link between the way growth is generated and the way income is distributed.[4] One of the most important determinants of the distribution of income among households (size distribution) is the distribution between different types of income, including wage, property and 'merged' agricultural income (functional distribution). The functional

Table 4.4 *Income share of the bottom 20 per cent of households (percentages)*

East Asian NICs	1950	1955	1960	1965	1970	1975	1978
Taiwan	—	2.9[a]	5.0[b]	7.8[c]	8.8[d]	—	—
South Korea	—	—	—	8.2[e]	7.5[f]	—	—
Hong Kong	—	—	—	—	5.6[g]	—	—
Latin American NICs	**1950**	**1955**	**1960**	**1965**	**1970**	**1975**	**1978**
Mexico	—	—	3.9[h]	3.7[i]	4.2	—	—
Colombia	—	—	5.0[j]	3.0[c]	3.2	—	—
Chile	—	—	—	—	4.8[k]	—	—
Brazil	—	—	3.0	—	2.7	—	—

[a] Based on figures for 1953.
[b] Based on figures for 1959–61.
[c] Based on figures for 1964.
[d] Based on figures for 1972.
[e] Based on figures for 1966–8.
[f] Based on figures for 1969–71.
[g] Based on figures for 1971.
[h] Based on figures for 1963.
[i] Based on figures for 1967–8
[j] Based on figures for 1962.
[k] Based on figures for 1968.

Source: S. Jain, *Size Distribution of Income: A Compilation of Data* (Washington, D.C., 1975); Korea 1975: H. Choo, 'Probable Size Distribution of Income in Korea: Over Time and By Sectors', in 1977 CAMS-IER Seminar; Taiwan 1975: C. Chen, 'Over Time Changes of Personal Income Distribution in Taiwan (1964–1974)' in 1977 CAMS-IER Seminar; and *World Development Review* tables.

distribution depends in turn on the use made of different factors of production in the development process in the context of a surplus labour situation. For example, if the product mix and the technologies used are increasingly labour-intensive, the share of labour income will usually increase. It follows from this that, because labour income is usually more evenly distributed than total income, the overall distribution of income will improve during labour-intensive industrialization. The size distribution also depends on changes in the distribution of particular types of income, the distribution of skills and physical assets between families, and the rate at which the reallocation of families between more or less equitable sectors of the economy takes place. In countries with a substantial agricultural sector, such as Korea and Taiwan, it is also helpful to distinguish between rural and urban households as differences in economic activity result in corresponding differences in income distribution.

growth rates but also high and rising levels of income equality due to the unusually high share of labour in national income and also to the rapid absorption of surplus unskilled labour into rural and urban industries during the course of the decade. During the 1950s and 1960s, the distribution of rural families' agricultural income also improved, first as earlier land reforms began to take effect, and later as new technologies were introduced. Innovations included a more intensive use of land through double cropping and the shift to more labour-intensive crops such as mushroom and asparagus, in place of the more land-intensive rice and sugar crops, which particularly benefited poorer farmers with small holdings.

Poor and landless rural families in East Asia, especially Taiwan, also benefited from the decentralized nature of industrialization. The development of rural industries meant that the share of total rural family income provided by industry increased from around 30 per cent at the beginning of the export-substitution phase to around 50 per cent by the time it ended in the early 1970s, with even higher percentages for smaller, poorer farmers and previously underemployed agricultural workers. Because rural non-agricultural income was even more equitably distributed than agricultural income, the overall equity of rural family income improved considerably during the 1960s and early 1970s. Moreover, rural industries were increasingly labour-intensive throughout the period, as shown by the high and rising share of labour in total rural income. Finally, the relaxation of controls on, for instance, domestic credit, foreign exchange, and the importation of raw materials, including fertilizer, prevented the continued discrimination against small-scale and rural enterprises common to other developing countries.

Though perhaps less spectacular than urban growth, balanced growth in the rural sector was an essential feature of the East Asian countries' successful economic development. Rural industries were able to offer extra employment and higher incomes to traditional farmers and agricultural workers, and the reduced costs of urbanization more than offset the loss of economies of scale that would have resulted from a more centralized process of industrialization. It is also true that the presence of a modern rural industry contributed to the modernization of agriculture, both by acting as an incentive 'window' and by making new technology and inputs readily accessible to farmers.

In the urban sector, where virtually all family income is generated by manufacturing and service industries, labour's share in total income was already impressive 50 per cent in the early 1950s to about 60 per cent by 1975, while in other developing countries, including the Latin American NICs, it has remained at about 40 per cent. So even in the relatively capital-intensive urban sector, the East Asian NICs, in recognition of their comparative advantage in unskilled labour, chose a more labour-intensive method of production and mix of products than is usual. The exceptionally high and rising share of urban income *before* the labour surplus was exhausted is contrary to the predictions of both Simon Kuznets and Arthur Lewis[5] and was a very important factor contributing to the overall equity of the distribution of income, especially in Taiwan.

During import-substitution the usual disbursement of windfall profits, by means of import-licensing, overvalued exchange rates and preferential interest rates acts as a disincentive to the efficient choice of products and processes. In the absence of adequate pressure to become efficient, domestic industries have little motive to thoroughly investigate the range of technologies on offer from abroad, or, more importantly, to undertake the local research and development necessary to adapt these technologies, as well as the choice of products, to local conditions. The choice of options is sometimes restricted by the simple lack of information, and sometimes by such institutional barriers as 'tying' by aid donors or by multinational salesmen. Patents and licensing systems may also limit the number of technologies and products from which local industry can choose.

In East Asia, from the early 1960s onward, policy reforms liberalized credit and foreign-exchange markets, reduced protection and thus encouraged and facilitated domestic producers in their search to compete successfully in foreign markets. The pattern of labour-intensive growth that emerged, balanced between urban industry, rural industry and agriculture, and based on import-replacement rather than simple imitation, was successful in rapidly generating employment until unskilled-labour-shortage conditions were reached by the end of the decade. The East Asian economies, in other words, successfully graduated from a rent-seeking society during the import-substituting 1950s to an efficiency-seeking society during the export-substituting 1960s.

III

The Latin American countries are far too dissimilar for us to be able to establish a Latin American 'type'. Even among the so-called NICs of Latin America it is hard to discover the strong resemblance that exists among the East Asian NICs (or, for example, the countries of sub-Saharan Africa).

Nevertheless, there are important general differences between, on the one hand, Korea and Taiwan, and, on the other, say, Colombia, Chile and Mexico, which must be borne in mind in any discussion of the broader relevance or irrelevance of the East Asian development pattern.

The features which distinguish the Latin American from the East Asian NICs include an earlier commencement of industrialization, a lower population density, more plentiful natural resources, a higher initial per capita income, a less equitable distribution of assets, a larger size, and, possibly, somewhat weaker human resources, in terms of a lower level of literacy and fewer skilled entrepreneurs.

Nevertheless, the earlier colonial experience of the Latin American NICs can be said to have been similar to that of Korea and Taiwan. On the whole, they exported land-based minerals or tropical cash crops to pay for imports of industrial consumer goods. And, as in East Asia, they later embarked on a strategy of import-substituting industrialization, probably towards the end of the nineteenth century (although some observers argue that it was not seriously initiated until the depression of the 1930s). Again, traditional export revenues were used to finance the emergence of new industries, which produced non-durable consumer goods in place of previous imports.

Growth rates in the Latin American NICs during the import-substitution phase were almost as high as in the East Asian countries, largely because of their natural advantages, including an abundance of raw materials, and their higher initial per capita incomes. But in Latin America the policies which accompanied import-substitution were generally more extreme than in East Asia, in part because the strategy persisted so much longer. One consequence of this was a much greater neglect of the food-producing agricultural sector, reinforcing the damage done earlier by the Spanish and Portuguese colonialists, who had largely ignored the agricultural sector in favour of the more lucrative business of mineral extraction. In both the Latin American and East Asian NICs, governments assisted the emergence of a new industrial elite from the old landowning and commercial elites by erecting protective barriers and ensuring windfall profits. The difference between them lies in the precise tools that were used to support import-substitution, in their severity, and in their duration.

The difference is best illustrated by the contrasting paths taken at the end of the initial import-substitution period. The Latin American NICs, faced, as in East Asia, with a declining rate of industrial growth and the threat of price wars in the protected domestic market, as early as the 1930s but certainly by the end of the 1950s decided to continue import-substitution but by shifting to the manufacture of producer and durable consumer goods, at first for the domestic market but after 1970 for export as well. This might at first glance appear to resemble the stage of more capital-intensive import- and export-substitution that began in East Asia in the 1970s; the crucial difference is that the Latin American NICs moved *directly* from the first stage of import-substitution to the production of more sophisticated, skilled-labour-, capital- and technology-intensive goods instead of *first* exhausting their labour surplus by means of an export-substitution phase. This strategy demanded an even greater degree of protection than before. Thus, while at the end of the initial import-substitution period protection was gradually reduced in East Asia, it was intensified in Latin America. (In the mid-1960s, for example, Korea had negative rates of effective protection on non-durable consumer goods, Brazil rates of 50–60 per cent.) Real interest rates remained low, if not negative; the agricultural sector's terms of trade continued to be depressed; and the neglect of the food-producing agricultural sector worsened, so that even countries traditionally self-sufficient in, or exporters of, food became net food-importers.

As a consequence, the East Asian NICs have restructured their economies far more towards exports (from 10 to 60 per cent of GDP over the past 30 years) than the Latin American NICs (from 10 to 15 per cent). Moreover, exports of manufactured goods have risen to a much higher proportion of total exports in the East Asian NICs (e.g. from 10 to 90 per cent in Taiwan compared with from 10 to 25 per cent in Mexico). Since the 1970s, however, even the Latin American NICs have substantially increased their export of non-traditional, manufactured, goods in response to the still low levels of domestic demand. Part of the increase has admittedly been in non-durable consumer goods, especially textiles, shoes and gloves. But most of it has been in higher-technology-, capital-intensive products such as cars, aircraft and electrical machinery.

This has taken place not because the Latin American NICs have been able to produce these goods competitively, but because such exports are now generally (even by Prebisch and his followers) recognized as a sign of successful development which governments are willing to subsidize. A much smaller percentage of Latin American than East Asian total manufactured exports are consequently directed to advanced industrial markets where they would presumably be best able to compete on the basis of lower labour costs.

In Latin America, therefore, the production and export of mainly capital- and technology-intensive products was promoted at the end of 'easy' import-substitution, while in East Asia labour-intensive export-substitution followed *prior* to the more capital-intensive import- and export-

substitution phase. The Latin American path did not require an overall change in policy. Whereas in East Asia governments reduced protection and encouraged market forces, Latin American governments could continue to select certain industries and firms for direct support in the form of tax rebates, preferential loans, and export subsidies, or by assuring private firms of continued high windfall profits in protected domestic markets in exchange for meeting rising export targets with internal (to the firm) subsidization.

The Latin American NICs were able to finance this prolonged period of import-substitution coupled, later, with export promotion – as well as to pay for an ever larger volume of food imports – by relying on their plentiful natural resources and, increasingly, their ability to attract foreign loans. But while the Latin American NICs were able, until recently, to maintain very respectable growth rates, their development strategy has been, for some time, socially costly. By skipping the initial labour-intensive export-substitution phase, and by moving instead straight to the capital-intensive import-substitution phase (with export promotion eventually added), the Latin American NICs achieved far less favourable employment and income-distribution levels than was the case in East Asia. Moreover, they laid the basis for the debt and growth crisis which has overtaken them in the last few years.

In the Latin American agricultural sectors, the initially worse distribution of land and the continuing relative shift towards primary export crops and away from food crops as import-substitution was maintained resulted in a lower labour-intensity and a less favourable distribution of agricultural incomes than in East Asia. The process of industrialization was also more centralized, i.e. rural non-agricultural income constituted a far smaller share of total rural family income. In Colombia, for instance, non-agricultural rural income's share has fallen from 15 per cent to 10 per cent during the past 30 years compared with a rise from 30 per cent to more than 50 per cent in Taiwan. Moreover, rural industries and services have been much more capital-intensive and have therefore contributed much less than in East Asia to improving the overall level of employment and the distribution of income. Finally, urban labour's share in total urban income has been much smaller – and has fallen steadily - over virtually the entire period. Given their initially higher levels of per capita income and smaller labour surpluses, the Latin American NICs would have needed a shorter period of labour-intensive export-substitution. Instead they tried to 'skip' the phase altogether and thus failed to mobilize the remaining pockets of unskilled labour in the development process.

What made it possible for the Latin American countries to nevertheless maintain high growth rates, even after 1973, was their ability to export raw materials and secure foreign capital inflow. Since 1979, however, they have run into increasing difficulties, as real interest rates have risen and protectionism increased, and, in the past couple of years, as oil prices have fallen and banks have cut back their lending. Since 1980, there has been virtually no growth in Latin America; imports have been drastically reduced and an increasingly larger share of export revenues is needed merely to service previously incurred debt.

The East Asian countries, on the other hand, have been able to maintain healthy growth rates. Both Taiwan and South Korea have thus far avoided serious debt problems. Since the early 1960s, Taiwan has not relied heavily on foreign borrowing, public or private, to finance its economic development; Korea has borrowed a great deal more, but, because its export performance has been consistently better than that of the Latin American countries, its debt has not reached unmanageable proportions. Both East Asian countries have shown a good deal of resilience in response to the worsening international environment of the 1980s, i.e. exports have continued to rise, albeit more slowly.

Contrary to popular belief, the East Asian NICs have enjoyed no special advantages in securing access for their industrial exports into US or other Western markets. In fact, the evidence suggests that whenever they have threatened troubled domestic industries, Western countries have retaliated by imposing 'voluntary' quota arrangements from which less successful or laggard countries, such as Indonesia, have remained exempt. It is worth noting, however, that once a country has reached the stage where it is able to compete successfully in international markets, it is likely to have acquired sufficient skill and flexibility to overcome many obstacles, including the defensive measures resorted to by the advanced industrial countries.

In theory, of course, a country should be better, not worse, off if it has an abundance of raw materials and access to foreign capital, in that additional resources should help ease the pains of policy adjustment. In practice, however, such 'advantages' may also be used to put off, or entirely avoid, such difficult policy changes. In the Latin American NICs decades of import-substitution have led to deeply entrenched habits and the emergence of powerful groups, including industrialists, organized labour and the civil service, with a vested interest in resisting reform or even fairly moderate changes in policy. Plentiful natural resources plus foreign capital, while they may ensure higher growth rates, also lead to an excessively 'strong' exchange rate which prevents labour-intensive exports from breaking into the international market. But plentiful raw materials and the easy availability of foreign capital also create a more important psychological barrier to policy change in that a country assumes it can 'afford' to continue import-substitution as it moves into ever more expensive and capital-intensive areas of production and export. The East Asian NICs (and at an earlier stage Japan) did not have the same easy alternatives as the Latin American NICs but were forced to stay more in step with their changing long-run comparative advantage.

IV

The Latin American countries can, of course, still move towards a more competitive export pattern and a more balanced domestic growth pattern, if they want to. A phase of labour-intensive industrialization may be essential – if only for a short period – to relieve unemployment and improve income distribution as well as to enable some of these countries to learn to compete effectively in international markets. The export of natural resources is likely to remain an important source of revenue in the long term, but balanced domestic growth, i.e. more productivity increase in domestic agriculture, will be likely to play a more important part in Latin American development than was the case in East Asia, not only because their domestic markets are larger but also because demand in the developed world is likely to be a relatively greater problem in the years ahead. By focusing mainly on the achievement of balanced domestic growth and, to a lesser extent, on developing a competitive export sector, the Latin American NICs can reduce their dependence on trade but without resorting to the usual costly protectionist measures. Even though the East Asian countries are smaller and thus have to rely more on exports, their ability to integrate export production into a vigorous balanced domestic economy has been crucial to their success in adjusting to domestic and external shocks during the 1970s and early 1980s.

It would be technically fairly simple for the Latin American countries to move gradually from selective export promotion to more general export-substitution. The problem of overvalued exchange rates, brought about by natural-resources export strength, which prevents industrial exports from entering world markets, can be addressed by monetary/fiscal policies and/or accumulating reserves abroad to try to sterilize the inflows. Minimum wage legislation can be postponed and union power kept in check until the remaining labour surplus has been exhausted. Most important, the rural sector can be made more productive, by improving its basic infrastructure, by undertaking the necessary research and development, and, more generally, by the central government adopting a less paternalistic attitude, especially towards local government, and fully recognizing the vital role it has to play in the course of successful development.

Latin American governments may, however, find it politically difficult to change course. Industrialists, for example, will be reluctant to exchange windfall profits in low-volume/high-margin domestic markets for earned income in high-volume/low-margin export markets. Nor will trade unionists be eager to accept lower wages in exchange for higher labour incomes, or civil servants a dismantling of controls which give them power. Those who lose most under the present system – the unemployed and underemployed in both the urban slums and the rural areas, as well as the medium, small-scale and would-be entrepreneurs – have relatively little influence on policy. Yet the scale of the present crisis may well force a change on Latin American governments. It should be noted that even the East Asian governments, generally considered tougher and brooking less opposition from relatively weaker trade unions and industrial interests, initially also found it politically difficult to abandon import-substitution and delayed introducing reforms for a number of years, until it became clearly impossible to maintain the strategy. Necessity, not superior wisdom, proved the mother of invention.

When the East Asian NICs did reform their systems, foreign capital was indeed useful in easing the adjustment. In the same way, the West can now play a vital role in assisting the Latin American NICs to introduce politically sensitive reforms – should they want to – by making additional loans contingent upon a commitment to long-term structural adjustment. In the past, despite all the talk of a need to restructure debtor economies, Latin America's creditors have preferred to concentrate on immediate debt repayment issues. Yet, in their own self-interest, commercial banks, financial institutions and donor countries should view multilateral discussions with Third World countries as a way to identify and correct the underlying developmental problems that have contributed to the present financial crisis. Such discussions could take place in an independent forum – along the lines of a country-focused Pearson Commission World Development Council – rather than appearing to serve the interests of any particular financing agency. Although there is a danger that both the donor and Latin American governments will prefer to conduct business as usual, the present crisis also provides an opportunity to tackle Latin America's underlying problems and thus simultaneously to ensure the stability of the international financial system.

In the real world, economies are, of course, far too complex to be divided into the distinct groups or well defined stages of development that have been used here to underscore the analysis. Yet the greater subtlety or 'greyness' of the real world also suggests that economies are sufficiently adaptable to change course at a given time. No development pattern is inevitable or irreversible, and there have indeed been important exceptions to the general trends in both East Asia and Latin America. South Korea, for example, is in many respects strikingly different from Taiwan and has much in common with some of the Latin American NICs, especially Brazil. Since the 1970s, when export targets were set and governments began putting pressure on individual firms to meet them, we have witnessed a partial return to import-substitution-cum-export-promotion, such as in the area of the petrochemical industries. Moreover, Korea's relative neglect of the agricultural sector, reversed only recently, meant that it had to rely more heavily (than Taiwan) on foreign capital; it has in the past borrowed more than ten times as much both to support rapid industrial expansion and to pay for food imports. Brazil, on the other hand, went in for a good deal of labour-intensive export-substitution, especially between 1963 and 1973, in the form of occasional bursts of exports of non-durable consumer goods such as textiles and shoes, in addition to its overall strategy of more capital-intensive import-substitution-cum-export-promotion. There are also strong indications that Brazil is now putting greater emphasis on the achievement of balanced domestic growth, in particular by increasing food production for domestic consumption relative to the production of primary cash crops for export. Colombia and the Southern Cone countries have attempted partial export-substitution packages in the recent past. And even Mexico had made some tentative progress towards trade liberalization and reform of its agricultural sector until it was interrupted by the oil boom.

Any attempt to establish the 'ideal' development strategy for a particular country must obviously take into account local conditions as well as the state of the world economy. The relative importance of a labour-intensive export-substitution phase will depend upon such varying factors as a country's size, population density, resource endowment, per capita income and wage structure. The scope for export-substitution will also be determined by the level of world demand. It is likely, however, that if the Latin American countries decided to undertake a major restructuring of their policies, they would achieve the flexibility to cope with increasing Western protectionism as well as other unanticipated exogenous shocks. Their relatively smaller labour surpluses and higher per capita incomes would, in any case, mean that a short period of labour-intensive export-substitution would be required. It would indeed be presumptuous as well as misleading to suggest that the policies followed in the past by the East Asian countries should now be adopted wholesale in the Latin American context. Nevertheless, a comparison of the economic performance of both the East Asian and Latin American NICs would seem to demonstrate fairly convincingly that more growth can be achieved via – rather than in spite of – an equitable, employment-intensive development path, and that the present debt crisis can perhaps yet be converted into an opportunity to address some fundamental structural issues. But this can only be done on a country-by-country basis with all the interested parties, most of all the country's own planners and decision-makers, participating and agreeing on the substance of required reforms.

NOTES

1 It is assumed here that in the course of transition to economic maturity, an economy passes through a number of phases, each with its own distinctive structural characteristics, ***modus operandi***, and associated policies. This is not to imply that any development path is 'inevitable' but simply to record what seems to have occurred in the four East Asian countries (and, at an earlier stage, Japan).

2 It is worth noting that Korea's less favourable initial conditions and subsequent agricultural policies resulted in lower levels and rates of increase of agricultural productivity, causing in turn an initially higher and faster-growing need for food imports.

3 The inverse U-shaped curve hypothesis states that as a country's per capita income improves over time, income distribution deteriorates until it reaches a minimum level – corresponding to the exhaustion of the labour surplus – beyond which income distribution improves with further increases in per capita income. (See S. Kuznets, 'Economic Growth and Income Inequality', *American Economic Review* (March 1955).)

4 See J. Fei, G. Ranis and S. Kuo, *Growth With Equity: The Taiwan Case* (Oxford, 1979).

5 S. Kuznets, *op. cit.* W. A. Lewis, 'Economic Development with Unlimited Supplies of Labour', *The Manchester School* (May 1954).